■ YUPPIE BUYING TRENDS • SCULLEY ON SABBATICAL • HOUSING FOR ALL ■

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FORTUNE

INSIDE THE MIND OF JACK WELCH

GE's chairman is pushing ideas that could transform the art of management

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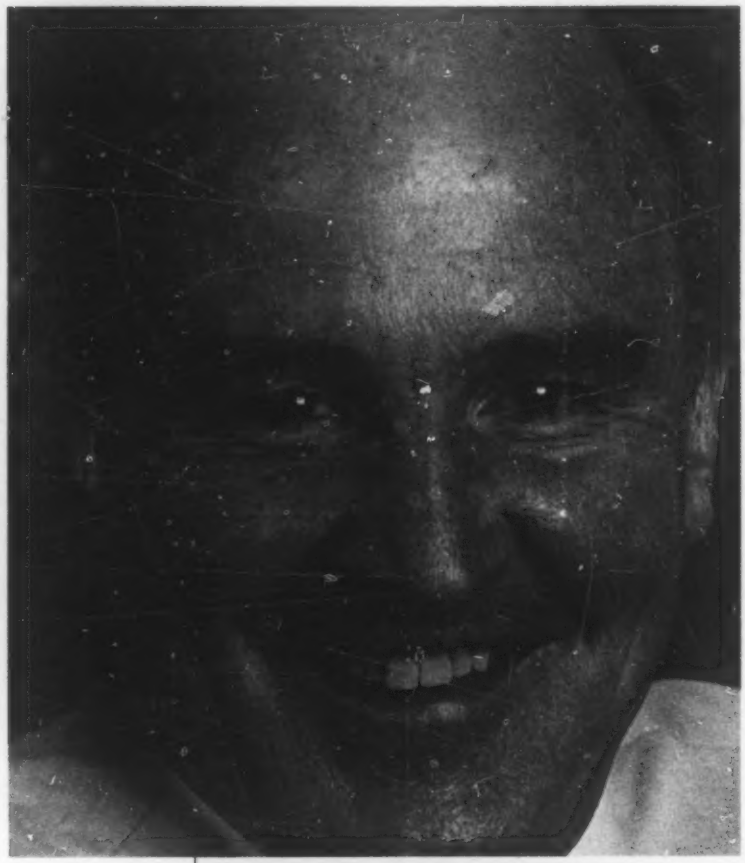

"If someone tells me, 'I'm working 90 hours a week,' I say, 'You're doing something terribly wrong.' I go skiing."
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MANAGING/Cover Story

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Fresh from his radical restructuring of General Electric, the controversial chief executive is putting the same fervor behind an attack on corporate bureaucracy. He wants to "empower" and "liberate" middle managers. His ideas are simple: Face reality. Communicate candidly. Control your own destiny. Put together, however, they could rewrite the textbook on how to manage a major company. *by Stratford P. Sherman*

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Washington spends poorly on the poor, and local governments block affordable homes for the middle class. Housing is a problem, all right, but it is not a crisis. Here's a blueprint for changes in laws and spending that can lead to decent housing for everyone. *by Louis S. Richman*

COVER AND ABOVE: Joe McNally photographed Jack Welch at GE's headquarters in Fairfield, Connecticut.

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"The commandment says, 'Honor thy father and thy mother.' It doesn't say anything about anyone else."

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"I'm a mere mortal."

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"Instead of gunshots, I hear birds singing."

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"I can't say I'd done it all, but I had come darn close to doing an awful lot of it."

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"I recognized that we politicians don't provide the jobs."

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"Mr. Levine, I think you're pathetic."

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EDITOR'S DESK

ANDY FREEBERG

Sherman takes a pause on the march to a manuscript.

JUST THE FACTS, MA'AM. American readers may well think of Joe Friday's line when they come upon the sometimes pompous pronouncements of journalists. But which facts? Held at a distance by the chief executives who shape American enterprise, most journalists must content themselves with describing the actions of corporate chieftains without much insight into the thoughts and emotions that drive them. Not so Strat Sherman. In this issue's cover story (page 38), Sherman takes you inside the mind of General Electric's controversial boss Jack Welch, whose powerful personality and unconventional ideas have the potential to transform the art of management.

Welch was wary at first, and understandably so. In eight years as chairman, he has gotten plenty of critical press for scything away over 100,000 jobs—one-quarter of GE's total. Though he had met Sherman twice before, he asked for an off-the-record lunch to look him in the eye and discuss ground rules. The discussion must have gone well. Welch agreed that no topic would be off limits, Sherman promised to be fair, and the two began what turned out to be five intense, two-hour interviews.

For perspective, Sherman and reporter Cynthia Hutton spoke with some 65 present and former GE executives, competitors, business consultants, and Welch's friends and critics. But the most telling material came from the man himself: "I was struck by the coherence of his thought and action," says Sherman. "He's also highly emotional and up-front about it. For all his reputation for toughness, he would get misty-eyed talking about his mother."

In the end Sherman, who has probably interviewed over 100 CEOs in his career at FORTUNE, concluded: "He's the best I've met so far. He's got the ideas and he's got the guts."

Also in this issue you will find articles addressing two of today's more compelling social questions. Washington bureau chief Lee Smith tackles the implications of our expanding elderly population and looks at how—and how much—we should pay for their care. Writer Louis Richman analyzes the equally vexing problem of how to supply affordable homes for the poor and middle class. In both cases, many people contend that huge increases in federal spending are the answer. The authors take a different view. For how we can meet these challenges without unacceptably burdening the taxpayer, see "What Do We Owe to the Elderly?" (page 54) and "Housing Policy Needs a Rehab" (page 84).

JOHN ABBOTT

Louis Richman

ROY HALSTAD

Lee Smith

EXECUTIVE EDITOR

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nursing home director: "They'd rather work at McDonald's and hire a kid to work for them in the nursing home." Well, why not? Another solution might be to offer retirees an insurance policy of sorts. For every hour they work in a nursing home, or take care of someone confined to her own home, they would get credits entitling them to free care should they need it.

Aging is a difficult, disturbing idea for most Americans. Perhaps that's because the society has so long focused on youth, or because the U.S. is so prosperous and medically sophisticated that anyone's inevitable decline is seen as some kind of failure. Even with the best of wills, there are limits to what the rest of society can do—either publicly or privately—for its aged citizens. Dylan Thomas had some good advice about not going gently into that good night. If the elderly can take that to heart and stop thinking of the burden of old age as somebody else's problem, there's no telling what imaginative remedies they will produce. ■

THE SENIOR BOOM: HOW IT WILL CHANGE AMERICA

It's hardly a secret: America is rapidly growing older. Yet the implications for politics, marketing, employment, and a dozen other facts of life are so vast that many people have not grasped them. In *Age Wave: The Challenges and Opportunities of an Aging America* (Jeremy P. Tarcher, $19.95) consultant Ken Dychtwald, 38, sets out to explain how this striking demographic circumstance will change our lives. Is the aging of America "the most important trend of our time," as the dust jacket proclaims? Maybe not. But it's awfully important.

Two major factors are creating the senior boom, as Dychtwald calls it. First, Americans are living longer. They are healthier and more active than any older generation before. As Dychtwald points out, average life expectancy in 1900 was 47; today it is 75, and within a decade it may reach 80. Second, births are plummeting. The fertility rate of today's women is half that of their mothers. So Americans over 65 will become a far larger part of the population, and the nation's median age will likely rise from 32 today to the mid-40s in 2050.

Those over 50 are only a quarter of the U.S. population now, but they are the most powerful and affluent consumer group in history. They control about 63% of the net worth of all U.S. households and account for 40% of total consumer demand. Yet he claims that the over-50 crowd is a market that most—but not all—of American business ignores. He writes, "It's likely that decades from now historians will look back and wonder why American industry worked so hard to sell to the youth market when it was their parents and grandparents who had most of the resources."

Dychtwald at home in San Francisco

Not that the over-50s are really old. One of Dychtwald's points is that as longevity increases, people will think of 60 as still a long way from old age. Yes, the body eventually begins to fail, and that creates hundreds of opportunities to cater to the elderly. In the world according to Dychtwald, levers will replace round doorknobs and faucets for arthritis-stiffened hands. Bathtubs and showers will have built-in seats. Cars will be equipped with larger side mirrors and dashboard display numerals. Public buildings with waxed floors will have to be carpeted so older people won't slip. Theaters will have low-level lighting in place of near total darkness.

Services will change too. Banks will offer more reverse mortgages so that home owners can continue to live in their houses while drawing on equity. Doctors will revive house calls. All kinds of transportation arrangements for the elderly will emerge, such as dial-a-ride jitneys with low-slung, wide-doored vans. Home deliveries will expand.

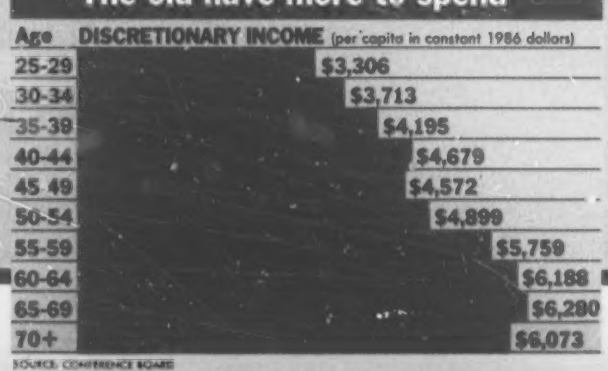
Companies are already responding. During holiday seasons some K mart stores offer special hours only for those over 55, so crowds stay small. Innovative drug and grocery stores are designing ways for older customers to avoid walking up and down the aisles. Instead they can call up a product on a television screen and automatically send the product to the checkout counter.

Dychtwald predicts the decline of what he calls the linear life, in which people get educated, work and have families, and then retire. Instead, they will live more flexible, cyclical lives, alternating work, education, and leisure. Employers will eagerly accommodate such flexibility because the number of jobs will probably grow far more than the number of workers in coming decades, and companies will need to court workers, including old ones. Retirement, says Dychtwald, will be retired.

The aging of America will even affect intimate relationships and the family, though just how is a bit tough to say. No one disputes that men become scarce as the years go by. Among Americans over 85, there are only 40 men for every 100 women. Dychtwald predicts that the man shortage will lead to all kinds of unusual alliances, including share-a-man relationships and even more same-sex relationships. It's happening now, he says.

– **Fern Schumer Chapman**

The old have more to spend



SOURCE: CONFERENCE BOARD

HOUSING POLICY NEEDS A REHAB

Washington spends poorly on the poor, and local governments block construction the middle class can afford. Here's a blueprint that can lead to homes for all. ■ *by Louis S. Richman*

WHEN WERE YOU LAST at a dinner party where someone didn't raise at least one of these perennially favorite topics: (1) how that $47,500 subdivision split-level, bought in 1973, is now worth a cool quarter million; (2) how married children, all with good jobs, cannot scrape together a down payment for even the draftiest bungalow in the town where they grew up or work; (3) how if the government doesn't quickly resume building subsidized housing, the ranks of the homeless will swell beyond imagining?

Thanks to new state laws, homes in this New Jersey development start at $39,950 . . .

Decent housing for all and widespread homeownership are major pieces of the American dream. But for many it looks like a dream perpetually deferred. The percentage of families who own their dwellings, which rose steadily for 40 years to a peak of 65.6% in 1980, slipped to 63.8% last year. That seemingly small decline means two million fewer homeowners. More than six million low-income households—nearly 50% of all people below the poverty line—spend over half of their incomes for rent. William C. Apgar Jr., director of the Joint Center for Housing Studies at Harvard, expresses a widely held view when he says, "America is being transformed into a nation of housing haves and have-nots." Most who worry about the trends assume that huge increases in federal spending are the answer.

A dispassionate look leads to other conclusions. First, there is a problem, not a crisis. Second, pouring more money into new subsidized housing won't help. What's required are federal and local policy changes that will allow the housing marketplace to work, along with carefully focused spending on the poor. The challenge presents Jack Kemp, the new Secretary of Housing and Urban Development, with a custom-built opportunity to test his free-market principles.

HOW MANY have-nots have we? Nobody can say for sure. Among aspiring first-time home buyers, young families in the 25 to 29 age group have been the hardest hit. The proportion who own homes has tumbled from 44% a decade ago to just over 36% today (see chart, page 86). Part of the reason—but only part—is that housing is now more expensive. The median-priced American home fetches $91,000—and in parts of the Northeast and California, the median is getting close to $200,000.

Costly residential real estate is to some degree a hangover of the late 1970s when the tornado of double-digit inflation lifted house prices clear into Oz. But the same winds also puffed up homeownership. Because mortgage rates were lagging behind inflation and house prices were rising 14.5% a year on average, smart young families saw a home as an unbeatable investment. Today, except in the tightest housing markets, prices are rising only about with inflation, and recent softening in some areas has raised fears of an actual decline in prices. Meantime, mortgage costs are higher, and lower income-tax rates have made interest deductions less important. Changing lifestyles have also reduced demand. Many people are postponing marriage—or abandoning the institution. Focus on the married couples who comprise the bulk of first-time buyers and you discover that ownership rates remain about where they were a decade ago.

Still, from anecdotal evidence alone, plenty of young people who want to buy simply can't. Some do not earn enough to carry mortgages, and their numbers have doubtless increased with recent interest rate hikes. A bigger obstacle, in the view of most experts, is that this generation of low savers cannot make the down payments.

The poor have a much worse problem in finding shelter, and their needs have outstripped federal assistance programs. Housing benefits, unlike Medicaid and food stamps, are distributed on a first-come, first-served basis to the limit of HUD's annual appropriation. This year its $12.4 billion housing assistance budget will reach just 28% of all who qualify. Some 7.7 million families fall through the cracks today, vs. six million in 1974. It's not for want of trying. Since the mid-Sixties the U.S. has spent about a quarter of a trillion dollars to

REPORTER ASSOCIATE *Charles A. Riley II*

. . . enticing hopefuls like Mike Pfeiffer, who recorded his visit to this three-bedroom townhouse costing $128,950.

build or subsidize the construction of over four million low-income housing units.

Government has not just failed to solve the housing problem: It has worsened it. Peter D. Salins, a professor of urban studies at New York's Hunter College, explains how. For all the money lavished upon it, government-built housing still accounts for a small proportion of the poor's shelter. Worse, it is outrageously expensive, inhospitable, and badly located. The money would go much further and yield more desirable housing, Salins argues, if it made the poor more like other consumers, able to pursue their desires in the marketplace. Zoning restrictions wreak further damage. Even as they clamor for more federal money to make housing affordable, local governments zone out the poor—and the not-so-poor.

Breaking the impasse has to start with meeting the needs of new home buyers. A healthy housing market relies on a concept that economists call "filtering." As new homes are built, more prosperous renters move up the housing ladder toward ownership. Their former apartments are freed up for less affluent tenants. Through a chain of such moves younger and poorer households are able to find acceptable apartments. But because so many young families aren't able to buy, the filtering process has broken down. Phillip L. Clay, an urban studies professor at MIT, estimates that middle-class renters now occupy some 20% of what was once lower-income housing in many tight urban markets.

Diddling with mortgage financing mechanisms to boost first-time buyers over the down payment hurdle offers only marginal help. The Federal Housing Administration's lending standards are already liberal, and loosening them further would merely risk more defaults. Allowing first-time home buyers to tap their tax-free IRA accounts might give some an extra push, but few young families have much in those accounts. A recent initiative in Michigan could turn into an open-ended drain on state funds. Governor James J. Blanchard wants to sell aspiring first-time buyers tax-exempt state bonds that would eventually cover their down payments. But if house prices rise faster than Michigan expects, the plan requires the state to make good the difference between the home buyers' savings and the amount they need.

Some buyers are making the nut by so-called equity sharing. In exchange for cash up front, a lender stakes a claim on the home's future appreciation—typically

PHOTOGRAPHS BY ALAN DOROW

DOUG MENUEZ

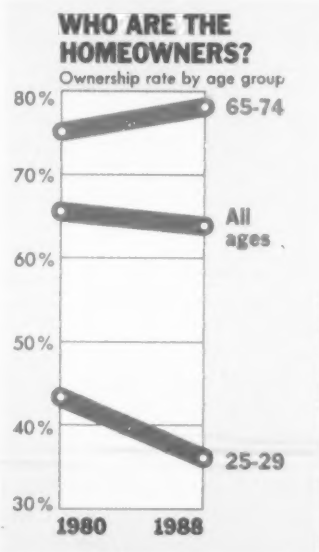
The Beatties of San Francisco: A nonprofit group built their $634-a-month apartment.

50%. But such deals make sense only in markets where appreciation is all but guaranteed. Elsewhere lenders find the proposition too risky. Kenneth T. Rosen, chairman of the Center for Real Estate at Berkeley, California, would spread the risk by having the FHA or the Federal Home Loan Bank Board, which oversees the nation's savings and loan institutions, establish a national shared-equity fund. Should home prices tumble in one part of the country, the fund would be cushioned by the gains it reaps in regions where markets remain tight.

Rosen's idea deserves a serious look. Meanwhile, many young home buyers continue to get down-payment help from those friendly bankers of last resort, mom and pop. The National Association of Realtors calculates that about a third of first-time buyers depend on family assistance to supplement their savings. Mom and pop are often in great shape to oblige. Ownership rates among the old continue to climb, and home equity loans make it easy to borrow against that built-up wealth.

The best solution to America's housing affordability problem would be to lower the cost of building homes. Filtering works best when the cost of developing new housing declines. So who is clogging the filter?

Don't blame developers. "The first-time buyer is a builder's bread-and-butter business," says John Phillips, a homebuilder in Olympia, Washington. "There is a steady flow of new customers as households are formed, and new families are likelier to buy when the economy is weak."



Declines among the young are pulling down the national rate. Oldsters are doing better.

Homebuilders have made impressive cost-saving gains. Since 1980 the inflation-adjusted cost of construction has fallen 6%. Further improvements are within reach as the industry shifts from on-site "stick built" homes to factory-made modular units. Paul F. Kando, a highly regarded advocate for factory-built housing who directs the Center for the House in Washington, calculates that today's manufacturing methods can reduce the average cost of building a spacious 1,865-square-foot home 27% to $61,142. Such savings would reduce the annual income a buyer in Pennsylvania, for example, needs to qualify for a mortgage by $6,760.

If developers can build affordable housing and want to, what's stopping them? The chief villain is a web of local zoning and land-use regulations, which codify communities' determination not to have it. Originally intended to impose sensible order on growth, many ordinances now serve as barriers to all but the costliest new housing. Some are outright capricious. In Phoenix, for example, city fathers insist that most new homes be built with Spanish tile roofs instead of cheaper asphalt shingling. This harmonizing touch adds up to $6,000 to the price new home buyers must pay.

Strict limits on density do the most damage. As communities braced themselves against an onslaught of growth, they stuck fast to—or tightened—zoning regulations that determine how many houses can be built on how much land. Because raw land costs are the fastest-growing component of new home construction, the only way to reduce the cost of building suburban housing is to increase the number of homes that can be built on a site. But pity the developer who tries to wheedle a density bonus out of a local planning board. Haggling with officials can easily consume two or three years, while the developer keeps his money tied up in the gestating project.

THE AGONY DOESN'T end until the project's neighbors have been heard from, and they would rather live next to empty lots. "Angry neighbors have become the fourth branch of government," says Douglas R. Porter, director of development policy research at the Washington-based Urban Land Institute, a planning group. Hovnanian Enterprises, a New Jersey–based builder of over 2,300 starter homes each year throughout the Northeast (including those in the picture on page 84), estimates that zoning battles and lawsuits tie up construction starts an average of four years. Hovnanian employs 16 full-time lawyers to guide projects through the regulatory maze and to battle irate neighbors.

Easing standards can yield dramatic savings. Portland, Oregon, for example, speeded up its approval process, reduced its infrastructure requirements, and allowed

builder Mike Robinson to boost the density of his North Meadow Village development from four homes per acre to nearly ten. The variances helped Robinson chop an average $15,647 out of the price of each of 58 single-family homes and sell them for $50,000 to $55,000. HUD and the National Association of Homebuilders undertook an experimental program in 29 other cities during the mid-1980s, using the most advanced construction techniques and cutting regulatory barriers. It produced savings averaging 15%.

But a new obstacle to affordability known as the impact fee has reared its head. Since local property owners still want schools and sewers but are unwilling to tax themselves, local governments make developers pay. An outgrowth of the late-1970s property taxpayers' revolt, impact fees often choke off the building of starter homes. Communities in 31 states now levy them, and in many they have become monstrous, bankrolling items on local wish lists such as parks and swimming pools. In Los Angeles County, the charges have ballooned from $3,000 to $22,000 per new home over the past decade.

Why don't developers resist? Far easier for them to get quicker approval for fewer, more expensive homes, whose buyers can more readily be stuck with the costs. Says developer Phillips: "You have the same fixed overhead whether you build a $50,000 home or a $300,000 one, but it makes up a far smaller proportion of the selling price of the expensive home." Throughout the U.S., says George Sternlieb, an economist at Rutgers, impact fees, zoning restrictions, and regulatory delays add 20% to 25% to the selling price.

WHERE OWNING IS EASY—AND WHERE IT ISN'T

MOST AFFORDABLE	HOME PRICE 1988 average	HOUSEHOLD INCOME 1988 average	MONTHLY PAYMENT AS A PERCENT OF INCOME
St. Louis	$96,500	$46,900	18.2%
Cleveland area	94,900	43,800	20.4
Miami–Ft. Lauderdale	103,400	44,400	20.7
Tampa Bay area	94,500	37,200	21.6
Kansas City	108,200	43,400	22.2
LEAST AFFORDABLE			
New York City area	$193,000	$55,400	35.5%
San Diego	169,100	45,200	33.4
Los Angeles area	186,000	50,700	33.2
Boston area	195,700	55,500	31.9
San Francisco Bay	198,500	56,400	31.3

SOURCE: THE LIST OF 53 MOST IMPORTANT RESIDENTIAL MARKETS COMPILED BY LOMAS MORTGAGE USA

Breaking the regulatory logjam will require states to curb local boards. So far only a few have tried, though several more are discussing proposals. New Jersey has come up with the most promising approach. A series of state supreme court decisions known as the Mount Laurel cases, which culminated in 1986, established that access to housing is a constitutional right for the state's residents and banned exclusionary zoning. The townships can still plan their growth, but the plans must make room for housing that residents earning below $18,000, 80% of the state's median income, can afford.

A statewide body called the Council on Affordable Housing, made up of public officials, residents, and a developer, certifies new local standards and arbitrates disputes. Since the system was introduced, most of New Jersey's fastest-growing communities have gotten certification. Douglas V. Opalski, the council's executive director, thinks the procedures have helped cut approval times to under a year and will spur most of the 145,000 units of affordable housing the state needs by 1993.

Though such measures will do a lot to unclog the filters, they will not by themselves get the poor housed. What to do? Let's start with what not to do. Building more subsidized housing is the standard solution, but using scarce federal funds for that purpose helps too few needy families. The Office of Management and Budget estimates that each new unit costs $70,000. To build the 250,000 units HUD financed yearly in the late-1970s would cost $17.5 billion—nearly half again HUD's present outlays—and barely dent demand.

The harshest indictment of federal construction spending is that much of it perpetuates the inner-city cycle of decay and welfare dependency. "The projects were intended to shore up declining neighborhoods," says Robert L. Woodson, who heads a conservative poverty research group in Washington called the National Center for Neighborhood Enterprise. "Instead they have turned into social dumping grounds and have isolated residents in pockets of poverty far from the jobs that would help them escape."

If the Feds aren't to build new low-income housing, who will? A congressional commission last year estimated that 17 million families will need help by 2003, vs. about 13 million today. But, the group estimates, the number of subsidized and private-market apartments will fall from

Kathryn Eastep, 74, pays $240 a month for this single room in San Diego.

ALAN D. LEVENSON

about 12 million to just under nine million.

The commission has overstated the problem. Its projected 2% annual growth in the number of impoverished families is extrapolated from a base year of 1982, the trough of a recession. It also made no allowance for any increase in the supply of affordable, unsubsidized private rental housing—which provides three-quarters of the poor's shelter.

ANOTHER WORRY is that some of the poor's existing housing could be wrested from them in coming years. About half of all subsidized housing since the 1960s was built by private developers enticed by FHA-guaranteed, low-interest mortgages and rent subsidies. In exchange, the developers agreed that their projects would serve low-income occupants for 20 years. Those obligations are now beginning to expire. According to the commission, 523,000 subsidized apartments could fall out of the stock over the next 14 years as owners of some buildings convert to market-rate housing and others default. Here again, the estimates are too high. Conversion is risky—the market may head south before the rehab is done—and the foreclosed units won't just disappear, since HUD will auction them off to new buyers. HUD projects the loss will not exceed 150,000 units.

Though vast, the remaining shortfall is beginning to yield to the efforts of hardy, private, nonprofit developers, supported largely by local businesses. Any federal program should aim to augment their efforts.

One such organization, Bridge Housing Corp., has put up 16 affordable-housing developments in the no-growth environment of greater San Francisco. Launched in a sublet office with a three-person staff in 1983, Bridge would rank as one of the nation's 100 largest homebuilders if it were a profit-making enterprise. Unlike older nonprofit housing development organizations born in an era of federal largess, Bridge structured itself as if it were a for-profit developer. Says President I. Donald Terner, formerly California's state housing director: "We knew we couldn't count on getting any federal money. We would have to wear suits and ties to the office, not Birkenstocks."

The Elekwachi family from Nigeria bought this $108,000 American dream built by a nonprofit group near San Francisco.

Bridge differs from for-profit developers in just two respects, not including Terner's nostalgia for sturdy sandals. First, it reserves 40% of its units for families with annual incomes no higher than $25,000—80% of the area median. The remainder go to families with incomes of $25,000 to $40,000, at market rates. Secondly, Bridge uses any profits from the market-rate units to reduce the cost or expand the number of units for lower-income residents.

To win over planning boards and neighbors, Bridge invests heavily in attractive architectural designs that blend with the surrounding community. In return it asks for relief from impact fees, along with zoning density bonuses that allow it to build up to 25% more units on a site. Having a for-profit partner helps: Bridge has worked with 11 Bay Area developers. "It stiffens the spines of local officials who have to stand up to angry neighbors," Terner says. "Bridge waves the flag of public purpose, and our partner offers a reassuring combination of financial depth and development experience."

Started with $5 million in grants from a local business group, Bridge has built or has under way more than 3,500 units with a construction value of nearly $250 million. Its success has spawned a half-dozen imitators around the country. And Terner expects that it will eventually inspire private developers to undertake affordable housing projects of their own.

In most cities, providing low-cost shelter relies on the scattershot efforts of energetic but largely inexperienced Birkenstock brigades. They are now getting help from a pair of nonprofit organizations with nationwide scope: the Enterprise Foundation, a Columbia, Maryland, group founded by developer James Rouse in 1981, and the Local Initiatives Support Corp. (LISC) of New York, begun with Ford Foundation money in 1980.

Both groups provide financial sophistication and management expertise along with funds. In Cleveland, for example, Enterprise has helped local groups put together an equity pool of $4 million from 25 local companies to rehabilitate homes. It leverages the private investment with public money, negotiates low-interest construction loans from local banks, and distributes the proceeds over eight projects.

With future occupants contributing sweat equity, each rehabbed unit can be sold for a modest $20,000 to families with annual incomes of $12,000 to $18,000. Enterprise has helped Cleveland's nonprofit groups lift production from 120 units a year to 300. They aim to remodel 1,000 homes a year by the early 1990s. (For more on what is happening in Cleveland, see Cities.)

ENTERPRISE uses its $20 million of assets to work with 86 local groups in 27 cities. LISC is raising over $50 million a year to finance development and rehabilitation in 25 cities. The groups' equity flows from a juicy federal tax credit that Congress passed in 1986. Investors can deduct from their federal tax bills up to 9% of the total cost of a low-income housing project each year for ten years after the project is occupied.

Corporations, however, have been slow to warm up to the program; they have claimed only $50 million in tax credits so far, though Congress authorized up to $300 mil-

MARC POSNANSKY

"Instead of gunshots, I hear birds singing," says Mary Ann Hughes. Housing vouchers, which let her move from a grim Chicago project to suburban Aurora, should be more plentiful.

lion per year. Investors are uncertain about the credit's future, and chary of being stigmatized as slumlords. Congress will soon reconsider whether to extend the credits beyond the end of this year. It should. As organizations like Enterprise and LISC continue to show that they can deliver attractive, cost-efficient housing, more corporate investors will be likely to ante up.

EVEN HOUSING the homeless and the working poor needn't require subsidies. Booming San Diego had lost more than 2,000 single-room-occupancy hotel units to new development since the mid-1970s. An investment group called BMW Partnership planned to raze the SRO on a parcel of land it owned. But when the site proved too small to convert, BMW decided to see if it could operate the hotel instead.

The developer ingeniously packaged its project to maximize amenities on the cheap. It wanted to provide each room with its own bathroom, for example, but subdividing the space to build partitions around the toilet, as the building code required, would have run up costs. So the partners asked the city to designate the entire room as a bathroom. Says managing partner Christopher J. Mortenson: "It offended the city council's notions of decency, but nowhere in the building code did it say that people couldn't sleep in 'bathrooms.' "

The owners did not scrimp on comforts for residents, however. Each fully furnished 120-square-foot room comes equipped with an all-tile shower, microwave, and TV. Total finished cost: $20,000 per unit—low enough for BMW to charge rents of $220 to $275 per month and turn a profit.

Residents are drawn from a cross-section of the elderly, working poor, formerly homeless—and the occasional European tourist happy to find a clean, cheap room reminiscent of youth hostels at home. To the 207 SRO units they now manage, Mortenson and his partners will add 418 by year's end. The partners have 400 more units planned, and with other developers starting to show interest, the city expects it will replace all its lost SRO space over the next three years.

So far, this thousand-points-of-light approach is adding just 25,000 units a year to low-income stock. How can Washington add battery power? The best approach would be to increase demand, or rather what economists call "effective demand"—the ability of more poor renters to afford market rents.

That was the course HUD followed during the Reagan years as it switched from new construction to a system of voucher certificates. At an average yearly cost of $3,500 per household helped, vouchers pay the difference between 30% of their income and the prevailing "fair market rent," which nationally averages $467 a month. HUD increased the number of recipients by nearly 45,000 a year over the past four years.

Stuart M. Butler, director of domestic policy studies at the Heritage Foundation and an adviser to Jack Kemp, proposes that the government vastly expand the program. He points out that the federal and state governments already distribute emergency housing assistance equal to HUD's $12.4 billion benefits budget, but it is scattered over several agencies. If all the funds were pooled under HUD, he estimates, vouchers could serve some 55% of all qualifying households—about the same proportion that entitlement programs reach—and cut administrative costs. As voucher use spreads and boosts the purchasing power of the poor, Butler expects the added demand will stimulate more private-market housing production.

OPPONENTS of vouchers claim that they merely strain the already short supply of cheap rental housing. But even leaving aside regional gluts, vacancy rates for low-income rental housing are high. More to the point, vouchers bring higher-rent housing within reach of the poor. Though recipients have their hardest time in cities like Boston and New York where rent control laws keep apartment turnover low, nearly all find apartments within 60 days.

The benefits of vouchers spread far beyond their principal aim. Instead of warehousing the poor in blighted ghettos, they allow recipients to decide where *they* want to live. In Chicago, James Rosenbaum, a sociologist at Northwestern University's Center for Urban Affairs, is tracking 114 black inner-city welfare mothers and their children who used vouchers to relocate in mostly white suburbs. "They blend beautifully into their new communities," he says. "This is the most promising approach I've seen yet to promote fair housing." It also puts the poor where the jobs are. Giving low-income Americans mobility and choice—something the old programs never did—offers the hope not only of housing them better but also of finally achieving the overdue national goal of a racially and economically integrated society. F

THE NEW GAME IN LIFE INSURANCE

Upstarts in the protection racket have forced old-line players to offer policies that are as much investment as insurance. That makes for happy customers and sad profits. ■ *by Terence Paré*

A GUY WITH A GIMMICK
Robert MacDonald, president of LifeUSA, has riled the industry by giving independent agents stock in his company.

A PRODUCT REVOLUTION has rocked the life insurance industry, with effects that reach from the companies' palatial home offices to the customers' kitchen tables where agents used to sell whole life policies over coffee and doughnuts. Giants have been staggered, upstarts catapulted into positions of great power. Only now, as the dust begins to settle, are the outlines of the industry's future becoming clear. And one huge question remains: Can anybody make much money in this business, once a famously sure thing? The industry isn't smug any longer, says Robert E. Carlson, executive vice president of Northwestern Mutual Life in Milwaukee: "Frankly, we're scared."

Companies that thrived for decades offering loved ones protection against "family variations" have been forced by new competitive pressures to provide policyholders with products that offer, along with the traditional death benefit, an attractive return as an investment. At stake is the more than $85 billion that Americans poured into life insurance last year. To the victors will go the customers, but to the customers go the spoils: cheaper, better products and a competitive rate of return on their money.

"Premiums mean profits" was the old life industry watchword, and from 1968 to 1978 total premium receipts more than doubled. But by the early 1980s rocketing interest rates had exposed the flaw in whole life insurance, which accounted for more than 70% of the industry's new premiums and most of its profits. The customer's rate of return on the cash value of a policy—the premiums paid plus the interest accruing on them, less the cost of the death benefit—was a mere 4.5%, in part because insurers typically invested the money in corporate bonds. True, that 4.5% was tax-deferred. But you had to hold the policy for 30 years to get it. Money market funds were already yielding savers in excess of 10%, and that rate seemed to be climbing every week. Term insurance, which is cheaper than whole life because it offers straight protection with no cash value, and universal life, which provides a return on cash value competitive with money funds, began nibbling at whole life's market share, ultimately eating into the profits of the old-line life companies.

The concept of universal life insurance, whereby the insurer puts the cash value of a policy into investments that yield a varying return to the customer, had been in the actuarial textbooks since the 19th century, says James C.H. Anderson, director of Towers Perrin, a New York actuarial and management consulting firm. But Ander-

HOLDING THE STEADY COURSE
Donald Schuenke made Northwestern Mutual's traditional whole life policies more competitive with the hot new products.

WINNING THROUGH DIVERSIFICATION
New York Life's George Bundschuh runs a self-styled "leader in financial services" rather than an insurance company.

son's paper on universal life, presented at a conference on insurance in 1975, was universal life's modern introduction. The first policy was sold three years later by a small insurer owned by the E.F. Hutton brokerage firm. It was an ideal vehicle for newcomers like Hutton and First Penn-Pacific, which didn't have much life insurance in force and weren't weighted down by big bond portfolios that were underwater.

OLD-LINE COMPANIES, which did have such portfolios, were already having a hard time competing in a high interest rate environment. In 1980, loans on policies were still available at 6% to 8%. Savvy customers borrowed against the cash value of their insurance to play the interest rate spread between their cost of borrowing and what they could earn in a money market fund, thus siphoning off the insurers' investment income. Insurers couldn't sell off their lower-yielding portfolios of corporate bonds and reinvest the proceeds in higher-yielding short-term securities without taking huge losses.

By the time the established companies began selling universal life in 1982, they found themselves cannibalizing their own business. Policyholders just turned in their whole life and reinvested the built-up cash in higher-yielding universal. Compounding the problem, upstart companies frequently guaranteed high minimum rates of return on the investment portion of universal life in order to woo business away from the established carriers. Old-line companies fought back with their own high returns. When rates turned down in the middle of the decade, many companies were locked into a money-losing situation. Says Robert W. MacDonald, chief executive of LifeUSA, one of those smaller upstarts: "They thought double-digit inflation would never end."

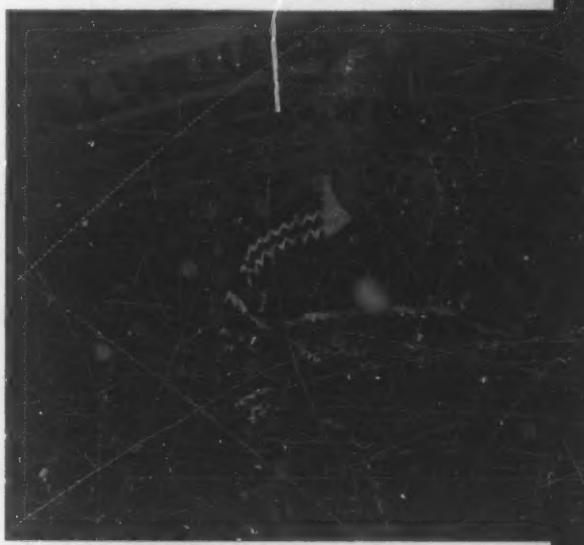
Lost in the competitors rush to grab market share was the distinction between insurance, a business of guarantees, and investment, a gamble. Once an insurance policy becomes an investment, the proper party to decide on risk is the purchaser. Variable life insurance, first offered widely in 1981, let him do so. As with traditional whole life and universal, part of the premium goes to buy protection, but in a variable policy, the death benefit and cash value depend entirely on the rate of return earned by a mutual fund selected by the policyholder for the savings portion.

Despite such occasional missteps as single-premium life insurance—the Treasury Department has decided to tax most single-premium policies as investments that only masquerade as insurance—life companies are in the investment products business to stay. "If I had my druthers," says Robert W. Barth, executive vice president of Equitable, "I'd prefer to have the traditional whole life products. But you have to have the new products the marketplace demands."

The trouble is that it is more difficult to make money selling this kind of insurance. The more the consumer gets out of life insurance, the less there is for the insurer. And consumers, many of them baby-boomers increasingly concerned about providing nest eggs for their children, are getting more and more. Insurers are getting less, much less. Says Harry G. Hohn, vice chairman of New York Life: "There's no secret about the fact that one of our industry challenges is lower margins on the products." Lower margins usually mean lower profits. Just how much lower is difficult to say because life insurance accounting remains dishearteningly complex (see box). But a look at life insurers' reserves over the past decade suggests what has happened to the overall profitability of the industry.

Just as banks invest depositors' money, life insurers invest the premiums they receive from policyholders. Those funds are recorded on the balance sheet as "reserves." The difference between what companies earn on the investment and what they credit to the policyholder is a basic source of profit. In 1978, insurers were earning at least 8% on about $177 billion of reserves for life insurance. Assuming they were crediting about 4.5% to the cash value of the policies, there was some $5.8 billion left for them. In 1988, life insurance reserves totaled an estimated $289 billion, but insurers say they made only a slim 1% profit, or a measly $2.9 billion, even though the amount of ordinary life insurance in force more than tripled to $4.6 trillion.

Putting an additional squeeze on profits



TERM'S APOSTLE
Art Williams, founder of A.L. Williams Corp., and his part-time sales force chant: "Buy term and invest the difference."

REPORTER ASSOCIATE *Reed Abelson*

PHOTOGRAPHS BY JAMES SCHNEPF

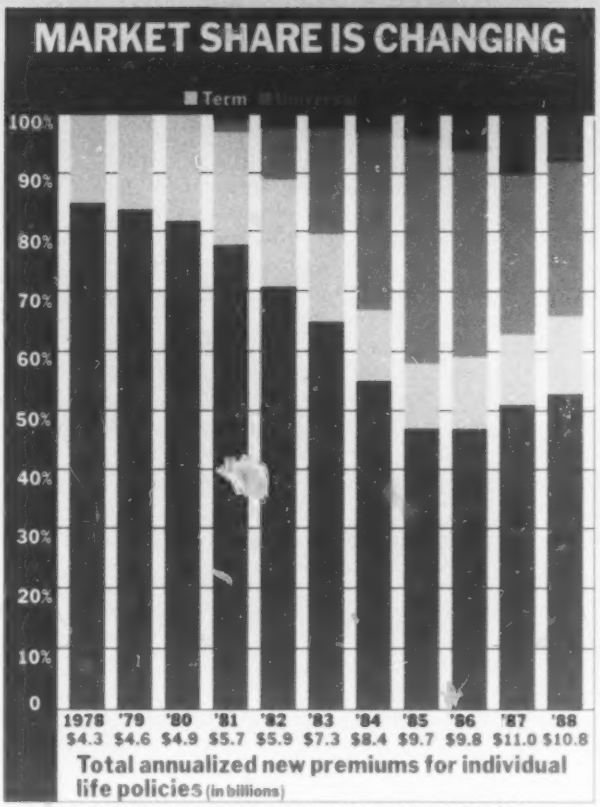
is the fact that life insurance agents, many of whom are now licensed to sell securities, are quick to pitch the policies not as protection in case of untimely demise, but as investments. Says Ronald L. Junkin, an independent agent in California: "We don't back up the hearse anymore." The upshot is that the market has become short-term oriented: Investors are always hunting for the best return. Voluntary policy terminations are hovering at 10% of all policies in force in 1988, compared with 6.6% in 1977, and at over 20% for policies in force less than two years. That's particularly disturbing to the companies that provide the insurance, since agents take their cut from the first year's premiums. The bulk of the company's profits are further down the road.

The resultant profit pinch has meant that in an industry once renowned for stable employment, executives are now talking about productivity and downsizing. Over the past two years, five insurers have put life insurance operations on the block. Other carriers are hiring fewer and fewer people. Still others talk about streamlining, which often translates into laying people off. Last June, for the first time in its 125-year history, Travelers, the Hartford-based multiline insurer, offered 420 people voluntary retirement packages and laid off 465 more. In 1988, Connecticut Mutual cut its local work force by 20%.

A PRODUCT PRIMER FOR LIFE INSURANCE

	PREMIUMS	CASH VALUE	DEATH BENEFIT	PREMIUMS (per $1,000 of coverage*)	
Term	▪ Buy protection in the form of a death benefit ▪ Payments increase when the policy is renewed	▪ None	▪ Amount is fixed	1978	$5.20
				1983	$2.90
				1988	$2.69†
Whole life	▪ Buy protection in the form of a death benefit ▪ Build a cash value ▪ Payments are fixed	▪ May be borrowed against by the policyholder ▪ Yields a fixed return guaranteed to be more than 4%	▪ Amount is fixed	1978	$18.20
				1983	$15.90
				1988	$14.55†
Universal life	▪ Buy protection in the form of a death benefit ▪ Build a cash value ▪ Payments may vary at the discretion of the policyholder	▪ May be borrowed against by the policyholder ▪ Is invested by the insurer to yield a return that varies but is guaranteed to be more than 4%	▪ Amount may vary at the discretion of the policyholder	1978	N.A.
				1983	$11.30
				1988	$10.08†
Variable life	▪ Buy protection in the form of a death benefit ▪ Build a cash value ▪ Payments are fixed	▪ May be borrowed against by the policyholder ▪ Is invested by the policyholder in a choice of mutual funds ▪ No guaranteed minimum rate of return ▪ Amount varies with the performance of the mutual fund	▪ Guaranteed minimum amount ▪ Amount varies with the performance of the mutual fund	1978	N.A.
				1983	$15.70
				1988	$13.26†
Variable universal	▪ Buy protection in the form of a death benefit ▪ Build a cash value ▪ Payments may vary at the discretion of the policyholder	▪ May be borrowed against by the policyholder ▪ Is invested by the policyholder in a choice of mutual funds ▪ No guaranteed minimum rate of return ▪ Amount varies with the performance of the mutual fund	▪ Guaranteed minimum amount ▪ Amount varies with the performance of the mutual fund ▪ Amount may also vary at the discretion of the policyholder	1978	N.A.
				1983	N.A.
				1988	$11.70†

*Figures are the average of first-year premiums for all policyholders. Premiums in later years will vary, depending on the product. **Newer policies may permit the policyholder to adjust the premiums, cash value, or death benefit. †Figures for 1988 are FORTUNE estimates.
SOURCE: LIFE INSURANCE MARKETING AND RESEARCH ASSOCIATION



SOURCE: LIFE INSURANCE MARKETING AND RESEARCH ASSOCIATION ESTIMATES

Companies that remain in the life insurance business have responded to the crunch with three basic strategies. Some have transformed themselves into diversified financial outfits, offering a myriad of products and services. Others have concentrated on their niches, improving their existing products and containing expenses. Still others are changing not the products they sell, but the distribution systems used to sell them.

New York Life, one of the oldest and largest of the mutual companies—mutual companies are owned by their policyholders, whereas stock companies are owned by investors—now describes itself as a "leader in financial services" rather than as a life insurer. The mix of the company's 1988 business bears the description out. Ten years ago New York Life derived 52.6% of new premiums from sales of traditional whole life and term life policies. In 1988 that figure was a mere 16%. Most of New York Life's premiums came from investment-type products, annuities, and pensions. Group life and health insurance, which accounted for 20.8% of revenues in 1978, represented only 6.9% in 1988, little more than the 6.1% that the company collected from sales of mutual funds run by MacKay-Shields Financial, a money management firm it acquired in 1984.

New York Life is one of many carriers that have acquired a firm specializing in money management. Once the unquestioned champs at managing retirement fund assets, insurers lost that business to feisty independent money managers in the 1960s. They now are winning those accounts back, not by beating the independent hotshots, but by joining them. Prudential bought Jennison Associates Capital in 1985. Equitable acquired Alliance Capital Management in 1985 and Metropolitan Life bought State Street Research & Management in 1983.

These combinations have not always proceeded smoothly. Conflicts between genial insurance types and the intense "Lunch is for wimps" Wall Streeters may be unavoidable. Back in 1971, when Kemper Group was just a simple collection of insurance companies and not the diversified financial services operation it is now, James S. Kemper Jr., president and son of the company's legendary founder, moved the firm's headquarters from Chicago to Long Grove, Illinois, 39 miles away. There he had lakes around the buildings stocked with bass and bluegills so employees could fish during the lunch hour. Nowadays H. Ronald Schaad, who runs Kemper Investors Life Insurance, a subsidiary based in the Windy City—corporate headquarters remain in Long Grove—laughs at the thought of it: "I don't know whether they're fishing out there, but we sure as hell have no time for it here."

THOUGH Northwestern Mutual acquired its own brokerage, Robert W. Baird & Co., in 1982, Chief Executive Donald J. Schuenke views the acquisition as a simple investment. When other firms went riding off in all directions to find new products, Schuenke held the steady course, lowering the premiums on the company's existing traditional whole life policies, making them more competitive with the hot new stuff bursting onto the scene. The result? Schuenke is piloting what has for seven years been the most admired life insurer on FORTUNE's survey of corporate reputations. Says he: "We're not really doing anything different, we're just doing it more efficiently than anyone else." A calm port in a storm of change, Northwestern still offers its employees, the most productive in the business, a free lunch each working day.

Other companies sought to shore up profits by overhauling the system of agents through which life insurance is typically sold, a system long considered the most expensive and immovable obstacle to fundamental change in the industry. Agents are costly to train—about $150,000 per—and costly to keep. Typically, 50% of the first year's premium of a whole life policy goes to pay the agent's commission. Companies tried to change the agency system when the product revolution was at its most torrid. Established concerns, piqued when their agents defected to smaller carriers that offered the more competitively priced universal life products, flirted with the idea of changing the agency system, says George A.W. Bundschuh, vice chairman of New York Life. "But," he adds, "it was a strategic error, because you really do need a distribution force." Life insurance is still a product that is sold, not bought, and companies can't afford to alienate their agents.

The industry has tried sales techniques that completely bypass the agent, as anyone who has received junk mail knows. These so-called alternative distribution schemes have begun to have some success, although the amount of coverage sold—$44.5 billion—remains a tiny fraction of the ordinary life insurance in force. Annual sales of mass-marketed life insurance such as National Benefit Life and Colonial Penn Life just about doubled from 1985, to $9.1 billion in 1987. Only three states allow savings banks to sell life insurance: Connecticut, Massachusetts, and New York. But in 1987, the latest year for which figures are available, sales of SBLI in those states reached $4.9 billion, more than twice the previous year's.

A few carriers are trying to change not the system, but the agent. Over the past 12 years Art Williams, the founder of the upstart Georgia company A.L. Williams Corp., has assembled an army, 195,000 strong, of homemakers, firemen, policemen, and teachers, who sell term life insurance—and only term—in their spare time. They talk to their friends and neighbors over the kitchen table, much the way a life insurance agent always used to. Once a week, over the company's private television network, Williams exhorts his minions with

the fervor of a Scottish Covenanter: "Buy term and invest the difference." The message sells. Last year A.L. Williams collected premiums of $342 million, vs. $354 million for ordinary term sold by Prudential Life Insurance Co., the nation's largest life insurance company.

Most of the rest of the industry disdains Williams, regarding him as a huckster. His fervid hordes persuade people to convert their whole life into the vastly cheaper term and to reinvest the excess accumulated cash value in mutual funds, or more likely, say some aggrieved traditionalists, in a trip to Hawaii. Frank Nathan, an agent for New York Life for nearly 60 years, minces no words when discussing Williams: "He's doing a tremendous disservice to most policyholders. He's a menace." The coach's answer to his critics? "They may think we're a bunch of greenies riding into town on the back of a turnip truck. But the truth is we're beating their behinds."

Robert W. MacDonald, founder and president of LifeUSA, based in Minneapolis, has stuck with the traditional professional agency system and has also taken new steps to charge the agents up. In 1987, with backing from Transamerica, MacDonald launched the new company, offering all the latest products, but with a twist that irks the industry. Independent agents receive stock in LifeUSA for every policy they sell. Most life insurance is sold by captive agents who work for a particular company, while independent agents usually sell the insurance of more than one company. They are supposed to be evenhanded about the products they sell their customers. "How can an agent be objective if he has stock in one of the companies?" says a critic. MacDonald scoffs at such punctilio: "That's coming from a company that has a contract that says if the agents don't write exclusively for them, they'll be terminated."

AFTER A DECADE of change that has largely favored the upstarts, the initiative may be shifting once again to the venerable behemoths that have long towered over the industry. The 33 life insurers that have been in business for 100 years or more still account for more than half the $1 trillion in total assets of all U.S. life insurers and for about 40% of all the life insurance in force. With the product revolution that so rattled older carriers winding down, service is likely to be the primary factor in determining future market share. That returns the advantage to the huge companies like Equitable and New York Life that have the capital to invest, for example, in sophisticated computer systems. "It took us two years to prepare to introduce a new product in 1978," says George Trapp, vice president at New York Life. "We can do that in a couple of weeks now." Upstarts will likely have to join forces to survive in the thin air of this new capital-intensive atmosphere.

A formidable challenge for all insurers awaits in the shape of commercial banks, increasingly loud in their demands that they should be allowed to sell insurance. Other new competitors have already jumped in: Fidelity Investments, the giant mutual fund company, recently started selling its own life insurance.

As the ozone layer of regulation continues to disintegrate, the competitive environment will only get hotter. Life insurance companies, which grew and prospered by creating a product to protect Americans against unexpected change, have yet to devise a product that will protect themselves in the new world they are entering. F

BIG CHANGES IN BEAN COUNTING

Accounting is supposed to reflect the financial condition of a company, but with life insurers it more often resembles a trip through Alice's looking glass. So arcane is insurance accounting that it is nearly impossible to compare the financial performance of one company with that of another, let alone the profitability of the industry with that of any other business. Now, it seems, the Financial Accounting Standards Board, the rule-making body for corporate accounting, has had enough of Wonderland. In the offing are changes to make things clearer that may result in lower reported revenues and earnings for some life insurers.

The big change will be in the accounting for the carriers' universal life products, which include variable life and universal variable life. Traditionally insurers treated all premium receipts as revenue. That convention did not mislead anyone as long as the product was old-fashioned whole life insurance, where the premium was fixed for the life of the policy. But the terms of universal life contracts are flexible, permitting policyholders easier access to the cash value and the freedom to change payment schedules and death benefits. The new procedures ordered by FASB make insurers credit the premiums generated by universal life products to a policyholder's account, leaving only the portion that covers administrative expenses and the death benefit to be considered as revenue. Beginning with their 1989 financial statements, insurers that sell mainly these policies will likely be reporting much lower premium revenue.

Income figures could be hit as well. Under the old rules an insurance company actuary determined the liability an insurer booked for a policyholder's benefits—that is, when the company was likely to have to pay out and how much. In doing so, the actuary was permitted to factor into his calculations the hefty surrender charges a company would collect if a policyholder decided to cash in his policy. The new procedures permit the carriers to recognize surrender charges only when they are realized.

Companies are balking at the changes, which some see as meaningless numbers-shuffling. All the more so since the changes affect only certain companies and won't relieve them of other accounting burdens. Insurance is regulated at the state rather than the federal level, and the new FASB rules will not touch the statutory accounting principles that the carriers follow when filing financial reports with the insurance commissions of the various states in which they operate. Mutual companies, which include most of the goliaths that have been in business a century or more, will also be exempt from the changes: They are not public companies and hence don't come under FASB's jurisdiction. The new regulations will hit the annual reports and 10-Ks only of investor-owned carriers. But they account for 60% of the life insurance in force. That's a big enough group to kick up quite a fuss. FASB received over 120 letters of comment criticizing the changes.

YUPPIE SPENDING GETS SERIOUS

Those conspicuous consumers are settling down, eating in, and stashing their cash in quality furniture and Detroit wheels. They're even giving some of it to charity. ■ *by Faye Rice*

BRACE yourselves marketers: The yuppies, those ambitious, self-obsessed, young baby-boomers who flaunted their affluence and fascinated Madison Avenue, are toning down the flash. After leading their generation along the path of conspicuous consumption and debt overload, the big spenders are trading their exotic vacations and expensive restaurants for charity work, takeout food, and cozy nights at home. Says Faith Popcorn, chairman of the marketing consulting firm BrainReserve: "They are reaching for reality."

JOYCE RAVID

Volunteer Andrew Lipman raises money for New York City's Big Brothers Inc.

The reality is that these acquisitive creatures are aging and moving into a period of their lives when they are setting up house and having children. They remain the spendthrifts they always were, but the money isn't going into BMWs, cocaine, and champagne. Now they get their kick from furniture, home computers, and gourmet carry-out meals. Says Leo J. Shapiro, whose Chicago market research firm spots new trends: "Money is still the root of all yuppie happiness. They are just shopping more prudently."

Yuppies, the acronym for young urban professionals, are the top-earning 3.5 million baby-boomers whose personal incomes average $51,000 a year. They are well-educated college graduates, often with a year or so of post-graduate study. The term originally described affluent city dwellers, but marketers quickly broadened it to include prosperous suburbanites.

Traditional yuppies with the money to satisfy every consumer whim are still around. Take Larry Kent Woods II, 31, who lives in Birmingham, Alabama, and has zoomed up the ladder at Tele-Communications Inc., where he is now a divisional marketing director. A bachelor, Woods loves gourmet food, drives a Porsche 944, dabbles in the stock market, and recently bought a second home that he is furnishing with original art and "quality" antiques. Says he: "Money is the only scorecard that people keep track of."

But the trend is moving away from that scorecard. In a recent study conducted for Chivas Regal, two-thirds of yuppies claimed to prefer a less materialistic life. They also said they increased their donations to charity in 1988. Says investment banker Andrew Lipman, 29, who does volunteer fund raising for Big Brothers: "I've seen too many people on Wall Street who think that money and possessions are the only thing." Adds Suzette Brooks, 29, a lawyer who founded New York Cares, a volunteer group of young professionals: "Times are changing, and many of them want another dimension to their lives beyond going out every night and partying."

Focused on work and wealth, many upscale boomers delayed marriage and children, but the bulk have now crossed the 30 threshold. Yuppies today are more likely to be married, homeowners, and suburbanites than they were in 1985, according to a recent demographic study by Peter Kim, a senior vice president at the J. Walter Thompson USA advertising agency.

CREAM OF THE BOOM	POPULATION in millions	INCOME Annual average
All baby-boomers	76.0	$16,753
Yuppies	3.5	$51,000
Would-be yuppies	12.7	$18,000
Elite blue-collar workers	2.5	$45,000

SOURCE: J. WALTER THOMPSON USA

continued

Three economic bumps in the night also encouraged profligate youngsters to wise up. The first was the tax reform act of 1986, which chipped away at write-offs for tax shelters and credit-card interest. Then the dollar dropped against other currencies, and the prices of foreign goods jumped. The final assault on the boomers' pocketbooks came with the stock market crash of 1987. While most Americans took it in stride, Wall Street yuppies earning six figures a year were jolted to their essence. Says a 32-year-old commercial banker who is married to an investment banker and describes herself as frugal: "Before the crash we were shopping for a house in the $800,000 range. But entire departments at Wall Street firms were being wiped out, so we stopped shopping and began to save."

KATHERINE LAMBERT

Liz Morina (left) and Bob Murphy give chintz no chance in a Virginia Bloomingdale's.

In sheer numbers yuppies represent only 4.6% of the 76 million Americans born between 1946 and 1964, so marketers must also pursue yuppie copycats, those less affluent boomers who blew their wads on extravagant consumption and are now joining the switch to more sensible spending. Peter Kim has tagged the major copycats "elite workers" and "would-be yuppies." The originals and the two groups of imitators make up 24.6% of baby-boomers (traditional blue-collar and clerical workers and homemakers account for the rest), but by 1995, they will control close to 70% of boomer income.

Elite workers, or "electric blue collars," as they are sometimes called, are not college graduates, but they earn average incomes of $45,000, only slightly less than yuppies do, serving the high-tech industries. These data processors, medical technicians, and telecommunications repairmen don't fret about job security; they're in fields where qualified people are in short supply. Thus, they are dream consumers. They are just as likely as yuppies to spend freely on diamond rings, expensive stereos, and fancy cars, but they are even more willing to buy campers, snowmobiles, and wood-burning stoves.

These acquisitive blue collars are also just a tad behind the trend. They are still smitten with powerboats, cowboy boots, and designer jeans, and, unlike the yuppies, the fitness fetish seems to have passed them by. They drink bourbon and beer, smoke cigarettes, and chow down such high-cholesterol no-nos as bacon and eggs.

The would-be's are much closer to the affluent yuppies in spirit, but their bankrolls are weak. Though they are well educated, they work in low-paying professions like teaching and social work and so earn an average of only $18,000 a year. Keeping up with the yuppies has thrust the would-be's into more credit-card debt per capita than all the other boomers.

The crash had an enduring psychological effect on these people, and they are worrying about their highly leveraged lifestyles in an uncertain economy. At the same time the sagging dollar is forcing them to reevaluate their beloved foreign cars and clothes. Like yuppies, they continue to prefer Perrier to booze and travel abroad less often. Would-be's, like all boomers, are turning into sofa spuds and are losing interest in going out to the ballet, theater, and rock concerts.

SINCE THE YUPPIES set the trends, what they are buying now will soon be taken up by the copycats. Today's prestige purchase is a house, and when it comes to his castle, this prince wants a palace. The homes that are moving fastest are in the 4,000- to 5,000-square-foot range, which usually translates into six or seven bedrooms and a median pricetag of $500,000. Says economist Michael Sumichrast, publisher of *Real Estate Perspectives*: "They are simply not satisfied with a house. They want a statement." Though the copycats will never be able to afford half-million-dollar statements, they are doing the best they can in less expensive neighborhoods.

Furniture is the next spending priority. During the past three years sales have risen 23% to $161 billion—with most of the trade being in antiques and reproductions. "Affluent yuppies are very much influenced by instant tradition. That's why they like Ralph Lauren and Laura Ashley," explains Carl Levine, senior vice president of Bloomingdale's. Copies of 17th- and 18th-century English and French furniture and 19th-century American reproductions have been flying out of his stores. Says Levine: "They say they are looking for their roots, but their ancestors probably lived much more simply."

So did their parents. All three boomer groups are springing for oversize bathrooms with whirlpool tubs, and lavish entertainment centers—that's the room Dad called the den—packed with CD players, tape decks, VCRs, stereo TVs, and electronic diaries. Kitchens bristle with automatic breadmakers, pasta machines, food processors, and contraptions that dispense cappuccino. Boomers who never baked a potato are buying industrial ranges with microwaves and restaurant-size freezers. Says Frederick Elkind, director of Ogilvy & Mather's Consumer TrendSights division: "Home has become the mother ship. It has all these exciting things to entertain and sustain them."

Of course, some young families cannot afford a home at all (see Politics & Policy). For others, the expense of buying and fur-

REPORTER ASSOCIATE *Edward C. Baig*

WHAT'S HOT . . .	WHAT'S NOT
Minivans and Ford cars	BMWs
Furniture	High-priced women's fashions
Gourmet takeout food	Expensive French restaurants
Personal computers	Sailboats
Original contemporary oil paintings	Rock concert tickets
Diamond engagement rings	Running shoes
California Chardonnay	Champagne
Breyers ice cream	Häagen-Dazs ice cream
Compact discs	LP records

SOURCES: OGILVY & MATHER CONSUMER TRENDSIGHTS, J. WALTER THOMPSON USA, PRUDENTIAL-BACHE ECONOMICS GROUP, LEO J. SHAPIRO & ASSOCIATES

nishing a house leaves little in the kitty for anything else. Economist Edward L. Yardeni of Prudential-Bache Securities says the restaurant business has been flattening after two years of rapid increases. High-priced eateries in major U.S. cities are suffering most. In New York City, for example, yuppie haunts like Cafe Seiyo! an and Joanna have closed. The spenders have not forsaken status food altogether, they're just eating it at home. Business is so brisk at gourmet grocery stores that their numbers have tripled. In 1980 there were about 4,000 specialty food shops nationwide; by 1988 there were about 12,000. Says Phyllis C. Richman, food critic for the Washington *Post*: "Fancy carryout stores have become the adiunct kitchens for the young professionals with ambitious tastes."

At FBC Foods International, a gourmet shop in Denver, sales increased in each of the past two years even though the local economy has ptomaine. "We have fewer people shopping with us, but the ones that remain have elevated tastes," says owner Jane Dorsey. "I don't see yuppies cutting back at all." Hot sellers include beluga caviar at $58 an ounce, raspberries that recently sold for $6.79 a pint, and all types of takeout dinners, such as stuffed prawns at $12.95 a pound. Says Dorsey: "Even the kids of yuppies have developed sophisticated taste buds. They never pass up a chance to sample the pâté."

Meanwhile some food favorites are being forsaken according to Peter Kim. Yuppies are scooping up 60% less Häagen-Dazs than they were in 1985. Now they're into Breyers ice cream, which is cheaper ($1.69 a pint vs. $2.19) and lower in calories (160 per 4-ounce serving vs. Häagen-Dazs's 270). The oenophiles are swilling California Chardonnays, and sales of imported wine and champagne have declined 23% over the past three years.

Hit hard by changing boomer spending patterns—not to mention the wilting dollar—is the European car market. Total sales downshifted 27% during the past two years, including a 48% plunge at Porsche, 24% at BMW, and 15% at Mercedes. There is a new elasticity in yuppie demand: The good life is still possible even if "the ultimate driving machine" in the garage is a Ford. Affluent boomers are buying the sleek Taurus sedan, the sporty Lincoln Mark VII, and the macho Bronco II truck. Copycats are driving American also. Most were never able to afford European cars, so they bought Japanese autos, but those prices shot up too.

EUROPEAN CAR manufacturers are fighting back. "We're in a war," says Robert J. Sinclair, president of Saab-Scania of America. He has raised Saab's ad budget 30% and is stressing the car's family-oriented features, like roominess and its top safety ranking from the Highway Loss Data Institute, a nonprofit auto research firm.

Some forecasters believe that the yuppies will soon return to their extravagantly improvident ways. Says Fred Elkind of Ogilvy & Mather: "There has only been a tempering of the extreme flaunting of affluence. That same euphoria could easily repeat itself if the dollar rebounds." But even he thinks that some of the shift may be permanent.

The big spenders are having babies, and there tends to be a dramatic dropoff in trivial purchases after the arrival of children. Chicago consultant Shapiro figures that the more yuppies make, the more they spend on their children. If the household income is $40,000, parents shell out an extra $1,000 a month beyond their normal expenses for the upkeep of a child. The $50,000 household spends an additional $1,360 per month on a kid, and for parents earning $100,000 the tab is $3,000.

A young Philadelphia lawyer has discovered that his $70,000 salary is just enough to cover the mortgage on his "humble twin," the due bill on his old student loans, and shoes for his children, ages 5 and 2. He shares a 12-year-old BMW with his wife, who has not worked since the children were born. "I'm not trying to paint us as impoverished, but the cash is very low," he says. "With two children, we can't afford a flashy lifestyle."

The vanguard of the baby boom, always quick to change, will continue to lead its generation into new spending opportunities. But they've got 20 years of orthodontia, private school tuitions, and Princeton educations ahead of them. Goodbye, Häagen-Dazs. F

Larry Woods gets the fish eye in an Alabama takeout store.

MIKE CLEMMER-PICTURE GROUP